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IN THE

Supreme Court of the United States

October Term, 1944.

No. 81.

OTIS & CO.,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION and THE UNITED LIGHT AND POWER COMPANY,

Respondents.

BRIEF FOR PETITIONER.

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OTIS & CO.,
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SECURITIES AND EXCHANGE COMMISSION AND THE UNITED LIGHT AND POWER COMPANY,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR PETITIONER.

OPINIONS BELOW.

The majority opinion of the Securities and Exchange Commission is printed in the Record. (R. 2-33.) Also the dissenting opinion of Commissioner Healy. (R. 37-77.)

The opinion of the District Court, for the District of Delaware (R. 82-95) is reported at 51 F. Supp. 217.

The opinion of the Circuit Court of Appeals, for the Third Circuit (R. 123-143) is reported at 142 F. 2d 411.

GROUNDS OF JURISDICTION.

The judgment of the Circuit Court of Appeals, for the Third Circuit (R. 142) affirming a judgment of the District Court, for the District of Delaware (R. 95-97) comes before this Court on a writ of certiorari granted June 12, 1944. (R. 144.) The jurisdiction of this Court was invoked under Section 240 (a) of the Judicial Code. (28 U. S. C. A. Sec. 347a.)

STATEMENT OF THE CASE.

1. The Parties.

The United Light and Power Company is a holding company registered under the Public Utility Holding Company Act of 1935. Aug. 26, 1935, c. 687, Title I, Sec. 33, 49 Stat. 838, 15 U. S. C. A. § 79, et seq. (R. 3.)

The Securities and Exchange Commission ordered The United Light and Power Company to liquidate and dissolve, and to comply with said order, the Plan under review was filed. It was approved by the Commission. (R. 78-82.)

Otis & Co., Petitioner, is a stockholder which deems itself aggrieved by the order of the District Court (affirmed by the Circuit Court of Appeals) approving the Plan and directing that it be carried out. It is the owner of only 10 shares of preferred stock, a fact to which counsel for The United Light and Power Company have forcefully adverted (brief of The United Light and Power Company in opposition to Petition for Writ of Certiorari, page 4, et seq.), but Otis & Co. was the underwriter for the entire issue of preferred stock ($60,000,000 par value) of which the rights and preferences are affected by the proceedings now being reviewed by this Court.

2. Summary of Matter Involved.

The judgment which petitioner seeks to review is one wherein the Circuit Court of Appeals, for the Third Circuit, affirmed a final Order entered by the District Court, for the District of Delaware, approving a Plan submitted by The United Light and Power Company under Sec. 11 (e) of the Public Utility Holding Company Act of 1935, 15 U. S. C. A. Sec. 79k (e), to comply with the requirements of Sec. 11 (b) of the Act, 15 U. S. C. A. Sec. 79k (b).*

* The Securities and Exchange Commission will be called "Commission." The United Light and Power Company will be called "Power" and the Public Utility Holding Company Act of 1935, 49 Stat. 838, 15 U. S. C. A. Sec. 79, will be called "the Act."

The Plan was prepared and filed with the Commission by the management of Power, which management was elected solely by the common stock of Power and therefore the Plan might well be termed a "common stock" Plan. The case originated in the District Court on an application of the Commission pursuant to Secs. 11 (e) and 18 (f) of the Act for Court approval and enforcement of the Plan submitted by Power. The Plan makes provision for the liquidation and dissolution of Power by first distributing all of its assets to its preferred and common stockholders on the basis of 94.52% and 5.48% respectively, although the total assets of Power do not have a present value equal to the liquidation preferences of the preferred stock as set forth in the charter. The District Court, nevertheless, found the Plan to be "fair, equitable and appropriate to effectuate the provisions of Section 11" of the Act and entered an Order directing that it be carried out. Petitioner contends that it is not "fair and equitable" to the preferred stockholders, of which petitioner is one, because it permits the common stock to participate in the assets of Power before the preferred is fully compensated.

3. Short Statement of the Matter Involved.

The facts are not in dispute. Power is the top holding company in a large public utility holding company system. (R. 3, 28A.) As it is a holding company with subsidiary companies, which are in turn holding companies, Sec. 11 (b) (2) (Second sentence) of the Act proscribes its continued existence in that it directs the Commission "to take such action" as is necessary to make such companies "cease" carrying on such enterprises. The Commission itself took action prior to the filing of the instant Plan to terminate the existence of Power. By Order dated March 20, 1941, the Commission directed that Power "shall be liquidated and dissolved." (Holding Company Act Release No. 2636; R. 105-121.) The Commission found that the present Plan (R. 77, 98-102) "is the final step in fulfill-

ing the portion of our Order of March 20, 1941, requiring the liquidation and dissolution of Power" (R. 5), and then held that the present Plan "provides for the liquidation and dissolution of Power." (R. 8.) The District Court stated: "I accept the findings of the Commission that there is necessity * * * for Power to liquidate pursuant to Sec. 11 (b) (2)." (R. 86.)

The charter of Power provides that "Upon the dissolution or liquidation of the corporation, *whether voluntary or involuntary*" the holders of preferred stock shall receive $100.00 per share, plus accumulated dividends, "before any payment is made to the holders" of the common stock. (R. 37.)

The Commission first found that the Plan was appropriate to effectuate the provisions of Section 11 of the Act, and then said:

> "The second required finding, namely, that the plan is 'fair and equitable to the persons affected by such plan,' presents a more difficult problem. The assets of Power are, in our opinion, of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942.
>
> * * * * * *
>
> "* * * present book values of assets pro forma are clearly insufficient to cover the liquidation preference of Power's preferred stock. Similarly, on the basis of a capitalization of reasonably anticipated earnings of the enterprise[9] we are unable to find an over-all value for the assets which approaches $98,700,000.
>
> * * * * * *
>
> (R. 9.)

"[9] It is clear that capitalization of prospective earnings, rather than book values, is the principal criterion of asset value. *Consolidated Rock Products v. DuBois*, 312 U. S. 510."

"* * * In the light of all the circumstances, we conclude that on no reasonable basis for capitalizing prospective earning power could we arrive at a valuation equal to the liquidation preference.

"If the amount of the liquidation preference of the preferred stock ($100 per share plus accumulated dividends) is controlling, our inquiry must perforce be ended at this point in a decision that the preferred stock is entitled to all the assets of the corporation to the exclusion of the common."

(R. 11.)

The District Court said:

"* * * If the dividend claim is capitalized as a matured obligation, the total claim of preferred will be $98,700,000. All parties agree also that the assets * * * have not a present value equal to that amount. *If the contractual preferences are operative it is clear there will be nothing for the common shareholders.*

"The problem for determination is whether the plan is 'fair and equitable'. Concededly, the plan does not satisfy the 'absolute priority' rule which is applied in equity and bankruptcy reorganizations.[1] Under that rule, no plan can be fair and equitable which permits a junior security to retain an interest in the reorganized corporate enterprise before the securities senior to it have been paid in full (but not necessarily in cash) for the rights which they surrender. The value of the reorganized concern is projectively determined by a capitalization of the 'guess' earnings of the

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[1] Case v. Los Angeles Lumber Products Co., 308 U. S. 106; Consolidated Rock Products Co. v. duBois, 312 U. S. 510; Marine Harbor Properties v. Manufacturers T. Co., 317 U. S. 78; Ecker v. Western Pacific R. Corp., 318 U. S. 448, and Institutional Investors v. Chicago, M., St. P. & P. R. Co., 318 U. S. 523."

> new concern and comparing the valuation so arrived at with the total claims of the old senior securities. The present plan fails to meet this test, as junior interests are allowed to participate in the new capital structure of Railways when it is conceded that Railways' common is not worth $98,700,000 on any basis of valuation. *If the claims of the preferred stockholders are to be treated as matured as in an equity or bankruptcy reorganization, there can be no participation for the common stock under the 'absolute priorities' rule.*"
>
> (R. 86-87.)
>
> (Italics supplied.)

The Circuit Court accepted the findings of the Commission that "The assets of Power are * * * of insufficient value to satisfy the stated liquidation preference of the preferred stock in the amount of $100 per share for 600,000 shares, plus arrearages of $38,700,000, or a total of $98,700,000, as of December 31, 1942." (R. 127.)

Although the Commission, the District Court and the Circuit Court all accepted the fact that the common stock of Power was "under water" upon every reasonable estimate of the present value of Power's assets, they nevertheless determined that it would be "fair and equitable" to give the common stockholders 5.48% of those assets upon the instant liquidation, upon the theory that the present claims of the common and preferred stock upon the assets of Power *should be determined as though in a continuing enterprise.*

The Commission said (Commissioner Healy dissenting):

> "* * * In our view, it is not inconsistent with the bankruptcy and equity precedents to conclude that in reorganizations or liquidations to comply with Section 11, stockholders affected should be given participations according to their contractual or other rights determined *as though in a continuing enterprise*, and that

the process of compliance with the statute should not be permitted to mature liquidation preferences."

(Italics in text.)

(R. 13.)

The District Court said in considering this view: "This is a new approach to the problem." (R. 88.) The Court followed this new approach, and concluded:

"* * * the common stockholders should be given a chance to recoup, especially where the reason for liquidation is purely fortuitous, and where the future condition of the new enterprise is based on a surmise."

(R. 89.)

The Circuit Court in affirming the District Court, said:

"* * * Though the preferred stockholders of Power have contract rights which entitle them to the payment of $100 a share and accumulated dividends on liquidation or dissolution of Power, those rights, at least in the absence of insolvency, have not matured and cannot mature for the reason that the congressional mandate contained in the Act strikes across contract rights and the maturities embraced by them, severing them." (R. 135.)

This new approach is one which has divided the Commission. The majority has now adopted it. Previously the Commission had said that a plan to effectuate the provisions of Section 11 (b) of the Act, which provided for stockholder participation where the corporation was insolvent, would not be fair and equitable, but instead would run "counter to the statutory standards of * * * Section 11." *In re Genesee Valley Gas Company, Inc.* (1938), 3 S. E. C. 104, at 115. Commissioner Healy has set forth his views, which are in opposition to the majority, in a

vigorous dissent in this case (R. 37-77) and in other dissenting and concurring opinions.*

After concluding that the claims of the preferred and common stock to the assets of Power should be determined as though in a continuing enterprise, the Commission indulged in a speculation as to what might happen in such event, ignoring the fact that the Act requires that the enterprise "cease." Sec. 11 (b) (2) (Second sentence). The Commission guessed that, if the enterprise continued, the arrearages on the preferred stock could be discharged at the expiration of 15 years, after which time there might be earnings available to pay dividends on the common stock, and because of this possibility the Commission determined that the Plan was "fair and equitable" in giving to the common stockholders 5.48% of the assets, having a value of approximately $4,000,000.00. (See Balance Sheet, R. 4.)

SPECIFICATION OF ERRORS.

Errors intended to be urged are those specified in the Petition for Writ of Certiorari entitled "Questions Presented" (p. 9), the Court of Appeals having ruled adversely to the contentions of Petitioner upon the questions there stated. Re-stated, the errors are:

1. The Court erred in holding that the instant Plan is "fair and equitable" within the meaning of that phrase as used in Section 11 (e) of the Act.

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*International Paper and Power Company, 2 S. E. C. 274, at 285 ff.; Federal Water Service Corporation, 8 S. E. C. 893; Columbia Gas and Electric Corporation, S. E. C. , Holding Company Act Release No. 3885 (1942); Engineers Public Service Company, S. E. C. , Holding Company Act Release No. 4114 (1943); Puget Sound Power & Light Company, S. E. C. , Holding Company Act Release No. 4255 (1943); Southern Colorado Power Company, S. E. C. , Holding Company Act Release No. 4501 (1943); Virginia Public Service Co., S. E. C. , Holding Company Act Release No. 4618 (1943).

2. The Court erred in holding that claims of the preferred stock to preferences upon this "involuntary" dissolution or liquidation are not to be considered as matured and a claim upon the assets of the corporation ahead of the claims of common stock.

3. The Court erred in holding that a Plan to liquidate, submitted by a corporation under Section 11 (e) of the Act to comply with the requirements of Section 11 (b) of the Act, which allows junior interests to participate and receive part of the assets before senior securities receive their full liquidation preferences, may, nevertheless, be approved by a District Court as "fair and equitable".

4. The Court erred in not holding that the "full or absolute priority" rule, as established in *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, is applicable to the instant Plan which was submitted under Section 11 (e) of the Act to comply with the requirements of Section 11 (b) of the Act.

ARGUMENT.

1. Status of Power Under the Act and the March 20, 1941, Order of the Commission.

Section 1 of the Act deals with the "Necessity For Control Of Holding Companies" and provides:

> "It is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted * * * to provide as soon as practicable for the elimination of public utility holding companies except as otherwise expressly provided in this title."

Section 11 of the Act places a duty on the Commission to "take such action as the Commission shall find necessary" to carry out the provisions of the Act. The Commission, pursuant to the duty placed upon it by the Act, on March 20, 1941, found "that the liquidation and dissolution of The United Light and Power Company and United American Company are steps necessary to comply with the requirements of the statute." (R. 119.)

An Order was accordingly issued on the same date, March 20, 1941, providing, inter alia:

> "The Commission having filed its findings and opinion herein, in which the Commission finds, among other things, that the action hereinafter directed to be taken is necessary and appropriate for the purpose of bringing about compliance with the second sentence of Section 11 (b) (2);
>
> "It Is Hereby Ordered, pursuant to Section 11 (b) (2) of the Public Utility Holding Company Act of 1935, particularly the second sentence thereof, that:
>
> "1. The United Light and Power Company shall be liquidated and dissolved."
>
> (R. 120.)

The Order of March 20, 1941, further directed that Power:

> "* * * shall proceed with due diligence to comply with the foregoing order, and shall make application to the Commission for the entry of any further orders necessary or appropriate for this purpose; and the respondent, The United Light and Power Company, may submit to the Commission herein for its approval a plan proposing a method of complying with Paragraph 1 of the foregoing order on a basis which is fair and equitable to its security holders, and providing for a determination of the relative rights and interests of its security holders in connection therewith; * * *"
>
> (R. 120-121.)

No appeal was taken from the Order of March 20, 1941, which *became the fixed point* from which to survey the rights of the security holders of Power. This is not open to question by Power or the Commission, as it has already been settled by a judicial decision sought by them. See: *New York Trust Co. v. S. E. C.*, 131 F. 2d 274 (C. C. A. 2), cert. den. 318 U. S. 786, Rehearing den. 319 U. S. 781. There it appears that one of the early steps taken by Power to comply with the March 20, 1941, Order was to file a Plan with the Commission providing for the retirement of its outstanding debentures, then not payable, by the payment of principal and accrued interest only. The Debenture Trustee objected, and urged that as a prepayment was being made, Power should be required to pay the same premium which would be payable upon a voluntary call by it. The Commission approved Power's Plan. The Debenture Trustee appealed and lost. The Circuit Court said:

> "Much of the elaborate argument of the petitioners (the Debenture Trustee) becomes irrelevant when once it is realized that the order of March 20, 1941 requiring the liquidation and dissolution of Power was not only clearly within the scope of the statute under

which the Commission acted and justified by the facts but having become final *has thereby become the fixed point from which to survey the right they now claim.*"

(Italics supplied.)

On the question of contract rights, the Court held:

"* * * we pass to the substantial question of whether the plan providing for the retirement of the bonds was unfair and inequitable to the debenture holders in failing to require the payment of any premium.

"*That depends upon the contract rights of the debenture holders under the applicable principles of contract law.*

* * * * * *

"* * * The order under review was, accordingly, fair and reasonable to all parties in interest since it provided for the payment of the bonds in a way *which discharged in full the contract obligations* of the dissolved corporation."

(Italics supplied.)

On the question of the continued existence of Power, the Court said:

"This continued existence was made impossible by the valid final order of the commission dated March 20, 1941.

* * * * * *

"This involuntary destruction of the corporation deprived it of any freedom of choice except perhaps as to the cost of its funeral."

This decision, favorable to the then contentions of the common stock management of Power, is a holding, in effect, that an involuntary liquidation of Power took place through the March 20, 1941, Order. In other words, the Commission, acting pursuant to the mandate contained

in the Act, directed, on March 20, 1941, that the enterprise Power was engaged in "cease" and that Power itself die.

We, therefore, find that the status of Power from and after March 20, 1941, and prior to the filing of the instant Plan, was that of a corporation whose existence had been terminated by an order of the Commission made under legislative requirement. There was nothing left for Power to do but comply with the valid, final order that it file a Plan proposing a method of liquidation. *Power had no further right to keep going.*

2. Charter Provisions Relating to the Common and Preferred Stocks of Power.

The Charter of Power provides:

> "The Common Stock of the Company shall be subject to the rights of the holders of the Class A Preferred Stock."
>
> (R. 38.)

and further:

> "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, the holders of the Class A Preferred stock shall be entitled to receive out of the net assets of the corporation, whether capital or surplus, for each share of such stock, one hundred dollars and a sum of money equivalent to all cumulative dividends on such share, both accrued and in arrears (whether or not the same shall have been declared or earned), including the full dividend for the then current quarterly period, before any payment is made to the holders of any stock other than the Class A Preferred stock. Any assets thereafter remaining shall be distributable among holders of stock other than the Class A Preferred stock in accordance with their rights at the time of distribution."
>
> (R. 37-38.)

3. The Plan Ignores the Charter Rights of the Preferred Stock and Hence Is Not Fair and Equitable.

It is recognized and admitted by all parties hereto that the present value of Power's assets is less than the claim of the preferred stock upon a voluntary or involuntary liquidation. (R. 86.)

The instant Plan was filed pursuant to the provisions of Section 11 (e) of the Act, which require that in order for the Commission to approve it, the Commission must find it to be "fair and equitable to the persons affected." This Section provides further that if, as happened here, application is made by the Commission to a court for approval, the court also must find the Plan to be "fair and equitable." These findings were made by the Commission and the District Court, erroneously, we submit. In *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, 60 S. Ct. 1, 84 L. ed. 110, this Court held the like requirement contained in Section 77-B of the Bankruptcy Act, that in order for a court to approve a Plan of Reorganization there must be a finding that it is "fair and equitable," necessitated the application of the "full or absolute priority" rule. This Court accordingly held that the Plan there under consideration was "not fair and equitable," inasmuch as it allowed stockholder participation when the assets were not equal to the par value and interest on the bonds.

In the instant case the only difference is that the senior securities, which are not being fully compensated, are shares of preferred stock, rather than bonds. There can be no difference in principle, however, because a contract between security holders of a corporation, whether expressed in a bond indenture or in a charter, must have the same standing when assets are distributed, whether by way of reorganization or by way of liquidation. Certainly if the preferred stockholders in the instant case had held bonds calling for a payment thereon equal to the par value and accrued interest upon a liquidation, before the common stock received anything, the con-

tract would be recognized and the Plan denounced as not being fair and equitable.

That the absolute priority rule applies as between classes of stockholders has been held in a number of federal court cases.* This principle was recognized in several cases cited by this Court in Note 14 in *Case v. Los Angeles Lumber Products Co.*, 308 U. S., at pp. 118-119, 84 L. ed., at p. 121.**

The principle was also recognized in *Standard Gas & Electric Co. v. Taylor, et al.*, 113 F. 2d 266, cert. den. 311 U. S. 699, where the court refused recognition to securities subordinate to the preferred stock upon a finding that there was not asset coverage sufficient to equal the par value and accumulated dividends of the preferred stock.

The fact that the instant Plan was prepared and filed in order to comply with the requirements of the Public Utility Holding Company Act, rather than to adjust a financial embarrassment, certainly does not change the meaning to be given to the words "fair and equitable." In the *Los Angeles Lumber Products Co. case* this Court said that the words are words of art, and had acquired a fixed meaning through judicial interpretations in the field of equity receivership reorganizations, prior to the passage of Section 77-B. We know that many equity receivership reorganizations were reorganizations of solvent corporations, and to apply the words "fair and equitable" to any such reorganization made it necessary to give charter preferences full and absolute recognition. In *Consolidated Rock Products Co., et al. v. duBois*, 312 U. S. 510, 61 S. Ct. 675, 85 L. ed.

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* *In re Utilities Power & Light Corporation*, 29 F. Supp. 763, appeal dismissed (C. C. A. 7, March 9, 1940); *In re Chicago Great Western Railroad Co.*, 29 F. Supp. 149 (N. D. Ill., 1940); *In re National Food Products Corporation*, 23 F. Supp. 979 (D. Md., 1939); *In re Porto Rican American Tobacco Co.*, 112 F. (2d) 635 (C. C. A. 2, 1940).

** *In re New York Railways*, 82 F. (2d) 739 (C. C. A. 2, 1936) cert. den. 298 U. S. 687; *In re Daniel Meyer, Murray & Young*, 93 F. (2d) 657 (C. C. A. 2, 1938).

982, this court recognized that, "the absolute priority rule * * * applied to reorganizations of solvent as well as insolvent companies." (312 U. S. 527.)

It seems clear that the requirement in Section 11 (e) of the Act that a Plan must be "fair and equitable" requires the application of the "full or absolute priority" rule, as used in the usual sense, namely, that the *present value* of the assets of the corporation must be ascertained and senior securities must be fully compensated before junior securities can participate. That was not done in this case. The Commission and the courts below have taken the position that the usual rule of "full or absolute priority" applicable to reorganizations under the Bankruptcy Act or in equity, is not applicable to any reorganization, liquidation or dissolution, or other proceedings taken to comply with the Public Utility Holding Company Act. The rule cannot be so limited. *What difference exists between a financial difficulty forcing a reorganization and some other difficulty which makes it impossible for the corporate venture to continue and thus calls for liquidation or reorganization?* In the course of corporate history we have seen public policy expressed by Congress and the people in many acts and amendments including the Sherman [1] and Clayton Acts,[2] the National Prohibition Amendment,[3] the Hepburn Act,[4] and now the instant Act to terminate public utility holding companies. All of these affected the destinies of corporations, and some terminated the enterprises in which they were engaged. The continued existence of any enterprise cannot be foreseen or guaranteed. There can be no difference between a liquidation forced by financial difficulty and one forced by some other difficulty. A public policy expressed in an Act of Congress is now terminating the enterprise in which Power was engaged, as it previously had of

[1] 26 Stat. 209, 15 U. S. C. A. Secs. 1-7.
[2] 38 Stat. 730, 15 U. S. C. A. Secs. 12-27.
[3] Const. 18th Amendment.
[4] 34 Stat. 584, 49 U. S. C. A. 1, etc.

corporations which had become trusts or were in the liquor business. The liquidation and dissolution ordered by the Commission now marks the finish line. Whatever the expectancies have been, the order of the Commission directed that the corporate existence of Power be terminated. The rules of payment to the respective security holders at the end, as laid down by the charter of Power, must govern.

4. In Valuing the Common Stock as Having Rights in a Continuing Enterprise the Commission Acted Contrary to the Intent of Congress, the Act, the Effect of the Order of March 20, 1941, and the Law.

The Commission and the courts below deviated from the normal application of the "absolute priority" rule by concluding that the Act did not mature the claims of the preferred stockholders to their liquidating preferences, on the theory that the matter should be treated "*as though in a continuing enterprise.*" (R. 13.) They do not treat this as the end. They ignore the effect of the March 20, 1941, Order. This approach is diametrically opposed to the intention of the Congress in passing the Act. *The very purpose of the Act was to end the domination of great public utility empires by holding companies through the ownership of common stocks having no real share in the assets.*

Prior to the passage of the Act, the preferred and common stockholders of Power had embarked upon a common enterprise to conduct a public utility holding company system with Power as the top company. Power had for its business the holding of stock in subsidiaries which were in turn public utility holding companies . The Congress determined that such enterprises had become "injurious to investors, consumers, and the general public." Sec. 1 (c). The Congress thereupon determined to provide for the "elimination" of such public-utility holding companies. Sec. 1 (c). Section 11 contains the "death sentence" of the Act. In the instant case the enterprise in which Power is engaged has received its "death sentence" under the ex-

press terms of the Act and under the order of the Commission of March 20, 1941. (R. 120-121.) The present Plan is intended to administer the death blow required by the law. *It is the end.*

The Commission, acting pursuant to the mandate contained in the Act, directed that the enterprise cease, but then, with complete inconsistency, valued the rights of the stockholders in and to the enterprise as though it were to continue. This new approach is diametrically opposed to the position taken in the *New York Trust Co.* case, *supra*, where, in effect, the common stock management of Power urged that the debentures had matured so that only principal and accrued interest need be paid, as would be the case at maturity. Through that device they were able to escape paying debenture holders what they would have been entitled to receive if their rights had been treated as if in a continuing enterprise. Now, however, this same management makes an about-face and would have the rights of the common stockholders treated as though in a continuing enterprise. Can the management of Power, controlled by its common stockholders, compel the bondholders to forego call premiums on the ground that the dissolution of Power is immediately necessary, and then, pursuant to the same Order, compel the preferred stockholders to forego their dissolution preferences on the ground that the enterprise is to continue?

In the *Los Angeles Lumber Products Co.* case, *supra*, this Court rejected a contention made by the stockholders almost identical with the instant contention made on behalf of the common stockholders. There, it was urged that as the bonds had not matured when the Plan of Reorganization was proposed, the stockholders were in a position "to remain in unmolested domination and control over the property" and hence had an equity entitling them to participation. This Court pointed out that when the Plan was proposed, the stockholders had waived their rights and that, "Certainly the surrender of a right thus waived is not adequate consideration for the dilution of the bondholders'

priorities which this plan would effect." *In the instant case there was and is no stockholders' right "to remain in unmolested domination and control over the property,"* because the Act itself, in Section 11 (b) (2) (Second sentence) has proscribed the continued existence of the enterprise pursuant to the "policy" of "elimination" of public utility holding companies set forth in Sec. 1 (c) of the Act. Furthermore, the Act provides that the Commission shall take steps to see that voting power is "fairly and equitably distributed among the holders of securities," which, in this case, would require that voting control be taken away from the valueless, inundated common stock and given to the preferred stock, and this would prevent the common stockholders from continuing in unmolested domination and control of the enterprise. In any event, the order of March 20, 1941, has, in effect, terminated the existence of Power so that the common stockholders do not in fact have a continuing right to conduct the enterprise, or to have their rights valued on a theory that they have "a right to keep going."*

What the majority opinion really does is to re-write the charter of Power. Where the charter now reads that:

> "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, the holders of the preferred stock" shall be entitled to priority of payment,

(R. 37.)

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* Professor E. Merrick Dodd, in an article entitled, "The Relative Rights of Preferred and Common Shareholders in Recapitalization Plans under The Holding Company Act," 57 Harvard Law Review 295, 326, took the position that,

> "* * * what is involved is *the value of a right to keep going* which is not abrogated by Section 11 * * *." (Italics supplied.)

Professor Dodd fell into the error of assuming that there was "a right to keep going." It *was* abrogated by Section 1 (c).

the majority of the Commission would have it read that:

> "Upon the dissolution or liquidation of the corporation, whether voluntary or involuntary, *except a dissolution or liquidation under the provisions of the Public Utility Holding Company Act, or any other legislative requirement which the organizers might not have foreseen*, the holders of preferred stock, &c."

This cannot be done. The fundamental principle underlying the rights of preferred stockholders is inherent in the word "preferred". Such rights are usually limited. The consideration for making them limited, however, is that they are "preferred". In the instant case, no matter how successful or profitable Power had been, the preferred was entitled only to receive a fixed dividend of six per cent, and a return of the par value of $100 per share. The common was entitled to all that remained. Per contra, the common agreed that the preferred would always have its dividend and entire principal before the common would receive anything. The present Plan does violence to both that principle and that agreement. Suppose the earnings and asset value of Power were and had always been such as to amply cover both the preferred dividend rights and the par value of the preferred. In that case, of course, the market value of the preferred would be well over par, because in these days any preferred stock having a secured six per cent return commands a substantial premium. Would the preferred stockholders then have been entitled to a greater participation than the charter provisions call for? Would they be entitled to the value of the preferred stock "as in a continuing enterprise"? On the theory advanced by the majority opinion of the Commission, the equities would require a recognition of the enhanced value of the preferred, yet that could not be given without rewriting the charter. In the instant case, the preferred stockholders are entitled to priority of payment. *Their claim is on all the assets ahead of the common.* The assets

are not enough to pay them, and it follows that the common should be eliminated. To paraphrase Commissioner Healy: By no "strange legal alchemy" should the common get part of the assets. (R. 38.)

5. The Distinction the Commission Seeks to Make Between an Equity or Bankruptcy Reorganization and a Reorganization Under Section 11 of the Act Is Illogical.

The Commission and the courts below refused to apply the "full or absolute priority" rule as established in *Case v. Los Angeles Lumber Co., supra,* upon the ground that "bankruptcy and equity precedents" should not be followed in dealing with "reorganizations or liquidations to comply with Section 11." (R. 13.) The Commission pointed out that in equity or bankruptcy reorganizations new securities are distributed among the old security holders "according to their contractual and other rights determined *as though in liquidation.*" (R. 12.) (Italics in text.) The Commission then determined, however, that "in reorganizations or liquidations to comply with Section 11, stockholders affected should be given participations according to their contractual or other rights determined *as though in a continuing enterprise.*" (R. 13.) (Italics in text.) This reasoning is not logical if we consider the intent of Congress in passing the corporate reorganization provisions of the Bankruptcy Act * and in passing the Public Utility Holding Company Act.

The reorganization provisions of the Bankruptcy Act, like equity reorganizations, seek to preserve going-concern value, and seek to give a means of continuing the enterprise with only an adjustment among the security holders of the securities they hold. *Liquidation is not involved.* In fact, Sec. 77B of the Act contemplated liquidation only in the event a reoragnization could not be effectuated. The

* Sec. 77-B, June 7, 1934, c. 424, 48 Stat. 912, 11 U. S. C. A. § 207; Chapter X, June 22, 1938, c. 575, 52 Stat. 883 et seq., 11 U. S. C. A. § 501, et seq.

Section provided that when reorganization was abandoned, if the corporation was solvent the proceedings should be dismissed, or, if insolvent, that *then* an Order should be entered directing "the estate to be liquidated." Sec. 77B, subdivision (c), clause 8. In Chapter X similar provisions were inserted. Chapter X, § 236, 11 U. S. C. A. § 636.

On the other hand, Congress determined to "eliminate" public utility holding companies, particularly such as Power, and certainly did not intend that Section 11 should become a means of continuing the enterprise or preserving a going concern. If the distinction is to be made, it would seem that it should be the other way and that in equity and bankruptcy reorganizations the securities should be valued "as though in a continuing enterprise" but not so in reorganizations to comply with Section 11.

6. Any Plan to Comply With the Act and the Order Would Have to be "Fair and Equitable", and Hence Could Not Provide for Common Stock Participation.

The Commission, through its counsel, has urged both in the courts below and in their memorandum on the Petition for Writ of Certiorari in this Court, that the Order directing liquidation and dissolution was merely the mechanical device selected in this case, and has taken the position that through other devices such as recapitalization or merger under State laws, Power could have achieved the same result, because, the contention is, in order for a preferred stockholder to prevail in a State Court in opposing a recapitalization or merger, the stockholder would have to prove that the Plan was so unfair as to amount to constructive fraud. This position, however, begs the question entirely, because it assumes that Power is still a free agent in the sense that it can recapitalize, merge, consolidate, or take other unregulated corporate action without having to comply with the standards of the Act. Power is a registered holding company with the Order of March 20,

1941, against it, and with the Act directing the Commission to see to it that the enterprise it is engaged in be terminated. The Order not only directed that it liquidate and dissolve, but provided that it should do that which it has done, namely, file a Plan of compliance under Section 11 (e).

Power has been powerless since the Act became law to take any steps (whether by way of merger, consolidation, recapitalization, or the instant step of liquidation and dissolution), which would not be subject to the standards of the Act as set forth in Section 11, that the same be "fair and equitable to the persons affected." Thus the argument that at some other time or place some other corporation in a similar financial situation to that of Power, but not under the Act and not subject to an Order of the Commission, might distribute an even larger percentage of its assets to common stockholders whose stock is under water, is without force, because Power is not in the position of an unregulated company.

Undoubtedly, if Power sought to merge, consolidate, or recapitalize under some State law, without regard to the Commission, the Act or the Order of March 20, 1941, the Commission would be the first one insisting that Power could not do it, and that Power could act only pursuant to a Plan of liquidation and dissolution which the Commission could affirmatively find to be "fair and equitable." In dealing with the very same Order now before this Court, the Commission did take that position in the *New York Trust Co.* case, *supra*, when the Debenture Trustee urged that Power's liquidation should follow some other course and be guided by state law. In the brief filed for the Commission in the United States Circuit Court of Appeals, for the Second Circuit, the Commission's position was stated, at page 12, as follows:

> "The Commission cannot (as petitioners contend) leave the course of liquidation to the means and controls provided by local statutes."

The brief goes on to point out that where a registered holding company is directed, as Power was, to comply with Section 11,

> "* * * the Commission must exercise jurisdiction to see that the program for compliance with the statute and the Commission's orders is *fair and equitable* and in accordance with the rights of the parties."
>
> (Italics supplied.)

Since the *New York Trust Co.* case has been decided on the ground that this final dissolution matured the outstanding liabilities, so that *bondholders'* rights could not be treated "as in a continuing enterprise," it cannot now be "fair and equitable" to treat *other security holders* "as in a continuing enterprise."

Another instance of the Commission's opposition to compliance by way of dissolution under State law is the opinion of the Commission, "*In re The North American Company and Its Subsidiary Companies*," 9 S. E. C. 617. It shows that North American Light & Power Company, a registered subsidiary holding company of The North American Company, a registered holding company, called a meeting of stockholders for the purpose of having them vote to dissolve under state law. This was done while Section 11 proceedings involving the two companies were pending before the Commission. No Order directing a compliance with Section 11 had been entered, as here, and North American Light & Power Company took the position that the contemplated dissolution under state law would be a compliance with the Act. The Commission entered an Order prohibiting such action and said in its Opinion, inter alia:

> "In a Section 11 (b) (1) case, the statutory obligation and duty imposed upon this Commission is the determination of what action the Commission shall find

necessary to bring about compliance with Section 11 (b) (1)."

(9 S. E. C. 620)

* * *

"In effect, the company is taking upon itself, without supervision or authority of this Commission, the discharge of functions that Congress committed to this Commission.

* * *

"* * * it seems to us that The North American Company and its subsidiary, the Light & Power company, are acting in a manner that frustrates or aborts the statutory duty of this Commission."

(9 S. E. C. 621)

Not only did the Commission enter its own Order but, to stop the proposed voluntary dissolution, also filed a Complaint in the United States District Court, for Delaware,* alleging the facts in the Opinion referred to above, and, in paragraph 21 thereof, said: "The proposed dissolution of Light & Power is in circumvention of the Act." The prayers were to enjoin the holding of the contemplated meeting and to enjoin the company "from dissolving or liquidating."

The argument that the same or a better result could be achieved for the common stockholders under state law should receive the same reply the Circuit Court of Appeals, for the Ninth Circuit, made to a similar contention in the case of *duBois v. Consolidated Rock Products Co., et al.*, 114 F. 2d 102, at 108:

"it is further said that the plan must be held to be fair because it achieves, by one step, results which

* "*Securities and Exchange Commission, Plaintiff, v. The North American Company and North American Light & Power Company, Defendants. Civil Action No. 214.*" Filed June 4, 1941.

could be achieved under California law by several steps. Such fact, if it be a fact, is immaterial. This proceeding is pending under the federal law and must meet the requirements of that law."

The test which the Commission and the District Court must apply before approving a Plan filed under Section 11 (e) of the Act is not whether a proposed Plan is so unfair as to amount to fraud, but whether there can be an affirmative finding that the Plan is "fair and equitable." It makes no difference in the application of that standard what device be used, whether liquidation and dissolution, recapitalization, or merger.

When the Plan, whatever the device used, contemplates the surrender of outstanding securities for new securities, either in the same or a different company, it is not "fair and equitable" to force senior security holders to accept less than that which they are contractually entitled to receive. Any Plan by which common stock of Power is allowed to receive approximately $4,000,000.00, while the preferred stock receives less than its claim against the assets, i. e., par plus accrued dividends, would not be "fair and equitable" to the preferred stockholders. The means used is unimportant. The important thing is that under the present Plan $4,000,000.00 is being taken from the preferred stockholders and given to the common stockholders. No scheme should be allowed which will do that.

7. The Action of the Commission and the Courts Below Was Contrary to the Rule Laid Down by This Court in the Reading Case.

The District Court referred to the treatment accorded the Plan by the Commission as a new approach. It is only new in the sense that prior to this action by the Commission such an approach was considered unfair and subject to judicial condemnation. This Court prevented common

stockholders from enjoying the fruits of having their rights valued as in a continuing enterprise upon a dissolution forced by judicial decree in the case of *Continental Ins. Co. v. United States*, 259 U. S. 156, at 177-181, 66 L. ed. 871 at 886-888, and said:

> "*The rights of the common and preferred stockholders of the Reading Company inter sese are to be determined by the organization agreement of 1896.*"
>
> (Italics supplied.)

The decision in the *Continental Ins. Co.* case, known as the *Reading* case, must be ignored or overruled if the instant Plan is to be carried out. The only difference between that case and the instant one is that the former arose under the anti-trust laws and the liquidation and dissolution of the company was forced by virtue of the anti-trust laws, rather than, as here, by virtue of the Public Utility Holding Company Act. There, the common stockholders contended that in dividing the assets between the preferred and common stock, pursuant to a forced liquidation and dissolution, the common stock should be treated *as though in a continuing enterprise and not as though upon liquidation.* In that case the Reading Company and certain other companies were found to have formed an illegal combination and a decree was entered "requiring dissolution." This Court, in an earlier opinion had remanded the case to the District Court and directed a decree "dissolving the whole combination * * * and such disposition of the stocks and bonds and other property of the Reading Company as might be necessary." This was similar to the steps in the instant situation, in that the order of March 20, 1941, had directed the dissolution of Power and the disposition of its assets. The Reading Company proposed a Plan under which the assets of one of its subsidiaries were to be transferred to a new corporation and rights to subscribe to the stock of the new corporation were to be offered share-for-share alike to the preferred and common stockholders of

the Reading Company. These rights were very valuable and constituted a distribution of the surplus of the Company. The common stockholders objected on the ground that, but for the dissolution, the enterprise could continue and the surplus would be available for distribution on the common stock, and, therefore, a division of the surplus between the preferred and the common in accordance with the liquidation provisions of the charter was not fair. This Court ruled that a liquidation was taking place and the charter provisions governing liquidation had to prevail and that the rights of the common stockholders could not be treated as though in a continuing enterprise. The charter provided that the preferred and common should share equally in a distribution of assets upon a liquidation, and in directing that these charter provisions must govern, this Court in effect matured the liquidation rights of both classes of stock upon the "compulsory winding up and liquidation of the corporation." (259 U. S. 180.)

In the instant case the Public Utility Holding Company Act interdicted the enterprise, while in the *Reading* case the anti-trust laws interdicted the enterprise. In the instant case the order of March 20, 1941, directed the liquidation and dissolution as did the order of the Court in the *Reading* case. In both cases the Acts, plus the orders directing liquidation and dissolution, matured the claims of all classes of stock to the assets, and the rights of both common and preferred stockholders were, in the *Reading* case, and should be, in the instant case, determined by the charter.

* * * * * *

It would serve no useful purpose to duplicate the very able presentation of both the law and the facts made by Commissioner Healy in his dissenting opinion herein (R. 37-77) and in his dissenting opinion in the case of *Federal Water Service Corporation*, reported in 8 S. E. C. 893 at page 921, and in others. See footnote, page 8, supra. This Court is respectfully referred to those opinions for his complete analytical study of the principles involved herein.

CONCLUSION.

It is respectfully urged that the Plan under consideration is not fair and equitable to the preferred stockholders herein and that the approval thereof by the District Court should be reversed.

Respectfully submitted,

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APPENDIX.

The pertinent provisions of the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803 (15 U. S. C. §§ 79, *et seq.*), are as follows:

SECTION 1 (c):

> (c) When abuses of the character above enumerated become persistent and wide-spread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

SECTION 11 (a):

> (a) It shall be the duty of the Commission to examine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which

the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system.

SECTION 11 (b) (2):

(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

* * *

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any

company whose principal business is that of a public-utility company.

* * *

SECTION 11 (d):

(d) The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and, subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

SECTION 11 (e):

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection

of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.